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Estate Planning Tools and Tips

Timely Information for Advisors and Clients About Advanced Estate Planning and Family Wealth Strategies

Understanding Charitable Remainder Trusts

How to Secure a Lifetime Income, Save Taxes and Benefit a Charity

With a charitable remainder trust, you can accomplish the following:

- You convert a highly appreciated asset into a lifetime income with no capital gains or estate taxes.
- You receive a charitable income tax deduction in the year you transfer the asset to the trust, reducing your current income taxes.
- Using a life insurance trust to replace the full value of the asset, your children receive much more than if you had sold the asset yourself and paid capital gains and estate taxes. Plus, they will receive these proceeds income tax, estate tax and probate-free.
- You are able to make a substantial gift to one or several charities.

To learn how to secure a lifetime income, save taxes and benefit a charity, please continue...

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Understanding Charitable Remainder Trusts

How to Secure a Lifetime Income, Save Taxes and Benefit a Charity

One of the most commonly used forms of charitable tax planning is called the charitable remainder trust. It is a way you can convert a highly appreciated asset (such as real estate or stocks) into a lifetime income *without* having to pay capital gains taxes on the sale *or* estate taxes upon your death. At the same time, you can benefit one or more charities that have special meaning to you.

WHO IS IT FOR?

You can probably benefit from a charitable remainder trust if you are age 45 or older, own a highly appreciated asset, are in a high income tax bracket, would like to enjoy your profits now but want to avoid capital gains and estate taxes, and you wish to support charities.

HOW DOES IT WORK?

You transfer the appreciated asset into an irrevocable trust, naming one or more qualified charities as beneficiary. The trustee then sells the asset at full market value, paying no capital gains taxes, and re-invests the proceeds in income-producing assets. For the rest of your life, the trust pays you an income. When you die, the remaining trust assets go to charity. (That's why it's called a *charitable remainder* trust.)

WHY NOT JUST SELL THE ASSET MYSELF AND RE-INVEST THE PROCEEDS?

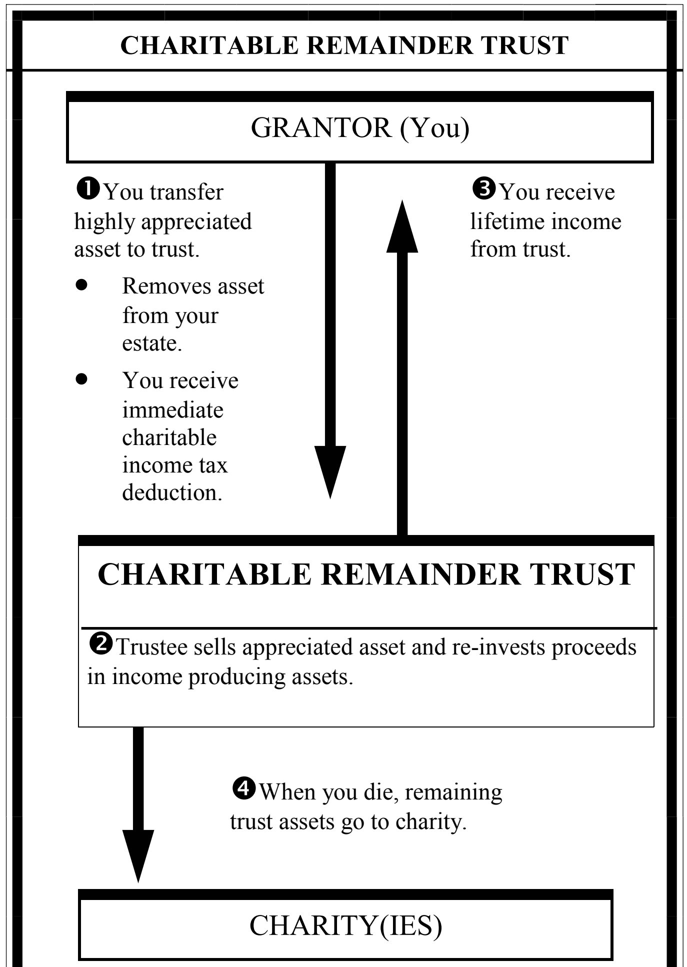
You could, but you would pay more in taxes, and there would be less left for you and your beneficiaries.

Here's an example. Let's say you and your spouse (now ages 60 and 58) purchased a piece of real estate 20 years ago for $100,000. It is now worth $500,000, and you would like to sell it so you can enjoy your profits.

If you sell the property yourself, you would have to pay $80,000 in capital gains taxes (assuming a 20% rate) on the gain of $400,000 (as shown on the left in the chart on page 2). That leaves you with $420,000 to re-invest. An 8% return would provide you with $33,600 in annual income. Multiplied by your life expectancy of 28 years, this would produce $940,800 in lifetime income. There is no tax deduction if you sell the property.

WHAT IF I USE A CHARITABLE REMAINDER TRUST?

After you transfer ownership to the charitable remainder trust, the trustee sells the property for the market value of $500,000, as shown in the chart below on the right. Because the trust does not pay any capital gains taxes, the full $500,000 is now working for you instead of just $420,000. The trustee then re-invests the proceeds in income-producing assets, like stocks and bonds. Using the same 8% annual return, that produces $40,000 in annual income which, before taxes, will total $1,120,000 over your lifetimes. That's over $250,000 *more* in income than if you had sold the property yourself. Plus, you can take an immediate charitable income tax deduction and reduce your current income taxes by $21,553.



A charitable remainder trust will let you convert a highly appreciated asset into a lifetime income—without having to pay capital gains taxes or estate taxes—and benefit a favorite charity.

WHAT ARE MY INCOME CHOICES?

You can receive a *percentage* of the trust income (as shown in our example), in which case your trust would be called a charitable remainder *unitrust*. With this option, the amount of your income will fluctuate, depending on investment performance—the trust will be re-valued each year to determine the dollar amount of income you will receive. If the trust is well managed, it can grow quickly, because the trust assets grow tax-free. So the amount of your income will increase as the value of the trust grows. Usually a "make-up" provision is included, so if the trust has an "off" year, it will make up the difference in income to you in a better year.

CAN I RECEIVE A GUARANTEED INCOME INSTEAD?

INCOME AFTER SALE

Market Value	$500,000	$ 500,000
Capital Gains Taxes*	-80,000	-0
Balance To Re-Invest	$420,000	$ 500,000
8% Annual Income	$ 33,600	$ 0,000
Total Lifetime Income (28 years)	$940,800	$1,120,000
Income Tax Deduction	0	$ 21,553

**Federal capital gains taxes only. There may be additional state taxes.*

Yes. You can elect instead to receive a guaranteed *fixed income*, in which case the trust would be called a charitable remainder *annuity* trust. This means the amount of your income will not decrease if the trust has an "off" investment year, but it also will not increase if the trust does well. An annuity trust is usually a good option at older ages. Also, although it does not provide protection against inflation like the unitrust does, some people like the security of being able to count on a fixed, predictable amount of income.

WHO CAN RECEIVE INCOME FROM THE TRUST?

Trust income, which is generally taxable in the year it is received, can be paid to you for your lifetime. Or, if you are married (as shown in our example), the income can be paid for as long as *either* of you lives. The income can also be paid to your children for their lifetimes, or to any person or entity you wish—although there may be some tax considerations if someone other than you receives it. And instead of lasting for someone's lifetime, the trust can be set up to last for a set number of years — up to 20.

HOW IS THE CHARITABLE INCOME TAX DEDUCTION DETERMINED?

It is based on the amount of income you receive, the size and type of property you gift, and your age. Basically, the more you elect to receive in income, the less your deduction will be. The deduction is usually limited to 30% of your adjusted gross income—although this can vary from 20% to 50% depending on how the IRS defines the charity and the type of asset you gift. If you can't use the full deduction the first year, you can carry it forward for up to five years.

WHAT KINDS OF PROPERTY ARE SUITABLE FOR A CHARITABLE REMAINDER TRUST?

The best assets are those that have greatly appreciated in value since you purchased them, specifically investment real estate, publicly traded securities, and closely-held corporations. Mortgaged real estate usually won't qualify, although you could consider paying off the loan.

WHO SHOULD BE TRUSTEE?

Because of the experience required with investments, accounting, and government reporting, many people select a corporate trustee—a bank or trust company that specializes in trust management. Some charities are also willing to be trustee. In some situations, you can be your own trustee—some people use a third party administrator to handle the paperwork for them. However, when deciding who will be your trustee, keep in mind that your trust must be administered properly—otherwise, you could lose the tax advantages and/or be penalized. Before naming a trustee, it's a good idea to interview several, evaluating their investment performance, services and experience with charitable trusts.

DO I STILL HAVE SOME CONTROL?

Yes. For as long as you live, your trust—not the charity—controls the assets. The trustee you select must follow the instructions you put in your trust, and the trustee's primary responsibility is to you—not to the charity. You can retain the right to change the trustee if you become dissatisfied. You may also be able to change the beneficiary to another qualified charity without losing the tax advantages.

CAN I MAKE ANY OTHER CHANGES?

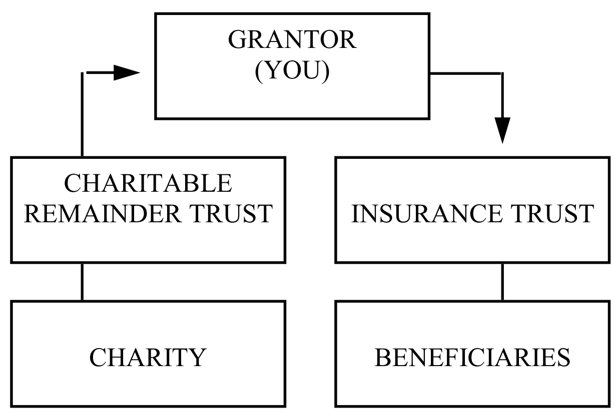
Generally, once an irrevocable trust is signed, you cannot make any other changes. So you will want to be sure to read the document carefully. Make sure it is exactly what you want *before you sign.*

SOUNDS GREAT FOR ME. BUT WHAT ABOUT MY CHILDREN?

If you have a sizeable estate, the property you place in a charitable remainder trust may only be a small percentage of your assets, so your children may be well taken care of. However, if you are concerned about replacing the value of this property for your children, there is a very easy way for you to do so.

As this illustration shows, you can take the income tax savings and part of the income you receive from the charitable remainder trust, and fund a life insurance trust. The trustee of the insurance trust can then purchase enough life insurance to replace the full value of the property for your children.

REPLACE ASSET WITH INSURANCE



Using the income tax savings and part of the income you receive from the charitable remainder trust, you can fund a life insurance trust to replace the asset for your children.

WHY USE A LIFE INSURANCE TRUST?

By using a life insurance trust, you keep the proceeds out of your taxable estate. Plus, life insurance is the least expensive way to replace the asset for your children—every dollar you spend in premium buys several dollars of insurance. It is also the quickest—the proceeds are available for your children immediately, even if you and your spouse should both die tomorrow. In addition, upon your deaths your children will receive the full proceeds from the insurance trust without probate, and completely free from income and estate taxes.

SO WHAT'S THE CATCH?

There really isn't one. This combination of the charitable remainder trust and life insurance trust is a winning situation for everyone—you, your children, and the charity:

- You convert a highly appreciated asset into a lifetime income with no capital gains or estate taxes.
- You receive a charitable income tax deduction in the year you transfer the asset to the trust, reducing your current income taxes.
- Using a life insurance trust to replace the full value of the asset, your children receive much more than if you had sold the asset yourself and paid capital gains and estate taxes, as shown in the chart below. Plus, they will receive these proceeds income tax, estate tax and probate free.
- You are able to make a substantial gift to one or several charities.

SUMMARY COMPARISON

Market Value	$500,000	$ 500,000
Capital Gains Taxes	-80,000	-0
Estate Taxes (45%)*	-189,000	0
Net To Children	$231,000	$ 0
Insurance Proceeds	+0	$ +500,000
Total To Children	$231,000	$ 500,000
Total To Charity	0	$500,000

**Estate taxes are based on the net value of your estate when you die. They start at 37% on every dollar over $600,000 and quickly increase to 55%.*

SHOULD I SEEK PROFESSIONAL ASSISTANCE?

Absolutely. If you think a charitable remainder trust would be of value to you and your family, you should speak with the attorneys at Price & Farrington, PLLC. We can assist you in the design, drafting and implementation of this valuable planning tool. We would be pleased to work with you.